

Drs. Jakob Moningka and Donald Rumokoy  
Fiscal Decentralization Implementation Plan for North Sulawesi

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# **Fiscal Decentralization Implementation Plan in North Sulawesi**

By

Drs. Jakob Moningga

Dr. Donald A. Rumokoy, SH

## **I. Introduction**

In recent years, there have been fundamental changes in the regional government system within the Republic of Indonesia. The changes are demanded by regional provinces that want a switch from centralized development model to more decentralized system, in order to empower regional resources optimally and achieve sustainable development. The end of centralized system has been the key demand of regional provinces. However, in the future centralized government system will still be a threat for the stability in the regional provinces: from time to time, both money and power (authority) are attractive issues to every level of government system anywhere in the world.

Changing to decentralized government system will generate transformations in many aspects of regional government implementation. It should be kept in mind that this change should be planned carefully, considering specific factors in each provinces/regions, so that the possibility of cultural conflicts – which in turn might disturb the efforts to achieve decentralization objectives – can be avoided. There is also a possibility that the new system will generate interregional conflicts within provinces, between provinces, or even conflicts between regional and central governments.

Therefore, it is necessary to determine what kind of community structure/condition we want to achieve in the future. Also, we should determine how to achieve the goal and what kind of instruments that can be used to do it. To describe the

condition of community in the future is not an easy task. There are many factors or variables affecting the process in building a community, and the structure and condition of the community in the future are not determined merely by the regional government system.

## II. Description of the region

North Sulawesi is a province that covers the northern part of Sulawesi island, including the archipelago in the north of the mainland region. In 2000, the population is estimated at approximately 2,821,000 people. The province of Sulawesi is divided into five autonomous regencies and three cities.

The five regencies (administered by Regents) are:

1. Sangihe Talaud regency (the islands which border on the Philippines)
2. Minahasa regency
3. Bolaang Mongondow regency
4. Gorontalo regency, and
5. Bualemo regency (split from Gorontalo regency in 1999)

The three cities (administered by Mayors) are:

1. City of Manado
2. City of Gorontalo
3. City of Bitung

The soil condition is fairly humid. Most of the agricultural is in public [??] plantations. Favored plantings include: coconut (in every regency), clove (in Minahasa regency), rice (in Bolaang Mongondow and Gorontalo regency), and nutmeg (in Sangihe Talaud regency).

In the mining sector, the most prevalent minerals are gold and kaolin. The industrial location is concentrated in Minahasa regency (in the northern part) and in the city of Bitung, producing (for example) fisheries and coconut oil.

### III. Distribution of Function, Authority, and Responsibility

The stronger demand of the provinces to gain more regional autonomy forces the central government and the parliament (Dewan Perwakilan Rakyat or DPR) to develop a democratic society, with certain objectives: equitable distribution of social welfare, and general prosperity.

In order to respond the current developments, both domestic and international, and to prepare for global competition, the central government together with the parliament declared law No. 22 / 1999, about regional government, and law No. 25 / 1999, about the fiscal balance between central government and regional governments. Both acts provide some general decisions about the distribution of function, authority, and responsibility between central and regional governments.

According to the responsibility in governing the nation, serving the people, and planning the development, a central government within a country has three main roles:

1. Allocation function: to allocate economic resources in the form of products and public services
2. Distribution function: to distribute public revenue
3. Stabilization function: to handle defense and public security, as well as fiscal and monetary policies.

The distribution and stabilization functions (2 and 3) are generally more effective to be performed by the central government, while **the allocation function in general is more**

**effectively performed by provinces (regional governments).** The regional government knows much better the needs and the service standard of the people in their region.

Based on this principle, it has been determined what kinds of authority should be reserved to the central government and what should be delegated to the provinces and to the regencies or cities. The central government still has broad authority in foreign policy, defense, court system, fiscal and monetary policy, religion. Other central government responsibilities include policies on national planning and national development monitoring and control (macro policy); allocation of national budget; national administration system and economic institutions; human resources development and empowerment; natural resources utilization; development of high technology and strategic industries; natural resource conservation; and national standardization.

The regional governments will have authority at different levels: limited autonomy at the province level, and full autonomy at the regency/city level. The province level has authority for responsibilities across regencies/cities, especially in fields/sectors that cannot be done by the regencies/cities level. The responsibilities at the province level include:

- a. Planning and monitoring of regional development (i.e., macro-economic policy at the province level),
- b. Training for specific fields, potential resource allocation, and research activities at the province level,
- c. Supervision of regional ports,
- d. Environmental monitoring,
- e. Trade and tourism promotion,
- f. Dealing with contagious diseases and plant diseases
- g. Spatial planning at the province level

In general, the authorities given to the regencies/cities will include everything except the responsibilities belonging to the central and provincial governments. Nevertheless, some essential authorities belong to the regencies/cities in order to implement the decentralization policy, i.e.:

- public works
- public health
- education and culture
- agriculture
- (public) transportation
- industry and trade
- investment,
- environmental protection
- land regulation
- cooperative firms
- labor/manpower

Decentralized authorities other than above are supposed to be done by regencies/cities. [??] However, in the case that a regency/city cannot do the authorities due to circumstances, the province can handle them for the short run.

Although religion is the responsibility of the central government, some of the religious activities can be delegated to the regional governments in order to enhance their participation in supporting religious activity in the region.

With the distribution of functions and authorities by jurisdiction, the responsibility on the implementations should follow where the distribution is delegated. For example, the public works that have been delegated to the regency/city level government, so they have to be done by the authorized government. In other words, the responsibilities cannot be delegated without certain regulations.

Even though (according to the new law of autonomy) most of administrative powers have been handed over to the local autonomy (regency/city level) due to the

strong demand of the regional governments, in reality – for the time being – not all of the regional governments are ready for implementing decentralization policy. Due to the limitations in the availability of budget/funding, natural resources, human resources, which are very diverse in each region of Indonesia, while there are some regional governments that are ready and prepared for accepting and implementing decentralization, on the other hand there are some others that are not ready for accepting complete or rapid decentralization.

In the North Sulawesi province, for example, which has 5 (five) regencies and 3 (three) cities, on average they have much lower local income than would be needed to implement administration functions under the decentralization plan. In Minahasa regency, which has been selected as a model for regional autonomy implementation in North Sulawesi province, its ability to conduct administration functions – such as public service and development planning – has not shown any significant progress. Meanwhile, Bitung city (which has an ocean port and owns several industries, such as fisheries, services, and coconut oil) clearly has the ability and willingness to implement decentralization plan.

One of the constraints faced by regional governments in the North Sulawesi province – and perhaps in most regional governments in the Republic of Indonesia – is the current lack of technical implementation guidelines of the Autonomy Act No. 22/1999 needed to regulate the implementation of the decentralization policy, such as government regulations (Peraturan Pemerintah). In the meantime, the tradition of asking ‘guidance and advice from the top government officials’ (i.e., being afraid of taking initiatives) is still very common among government officers, although this habit is usually associated with the old paradigm during the previous regime.

In responding to the question, “What is the right time to start implementing decentralization,” in our opinion – although there are a lot of constraints faced by the regional governments in North Sulawesi – we should start it now. If there are some

restrictions and difficulties in some regions, they should be reviewed and gradually fixed while implementing the decentralization in stages.

Therefore, in order that the decentralization of authorities can be implemented as soon as possible, the central government will have to set up the government regulations and the implementation guidance which are required to complete the current Autonomy Act.

#### IV. Revenue Assignment / Revenue Sharing:

The decentralization of authorities to the regional governments to conduct the administration functions in the regions (public service and development) requires improvements in the regional capability to organize their resources in order to finance and manage local administration functions and development activities.

The principles of regional autonomy are also democratic principles, such as public participation, equality and social justice, and regional diversity. There will inevitably be some regions with high potencies/advantages, while other regions may have limitations in implementing regional autonomy according to the Autonomy Acts No. 22 / 1999 and No. 25/1999 (and the government regulations and other implementation guidelines). Nevertheless, the regional autonomy concept as stated in the above laws should have been implemented. One of the purposes of regional autonomy implementation is to soften the demand of local people in the provinces, which can lead to national disintegration.

Under the previous system, when the Act No. 5 / 1974 about the principal of regional government was still applicable, it was stated in this act that the sources of regional revenue are:

- a. The original revenue of region, which includes:
  1. Revenue from local / regional taxes
  2. Revenue from local retributions
  3. Revenue from local companies' (taxes)
  4. Others, such as revenue from regional activities

- b. The revenue coming from the government, which includes:
  - 1. The budget allocation from the central / regional government
  - 2. Other allocations / contributions which are regulated by laws and government regulations
  - 3. Other regional revenues

With Laws No. 22 / 1999 and No. 25 / 1999, the structure and source of regional revenue have changed. Currently, the source of regional/local revenue comes from:

- a. The original revenue of the region
- b. The balance/equilibrium budget
- c. Loans
- d. Other local revenues

Before the implementation of the new law, regional taxes were divided into Province taxes and Regency/City taxes. Province taxes included taxes from motor vehicles/cars, and fees to renew license plates of motor vehicles. The number of regency/city taxes included more than forty tax items, such as: non-motor vehicles taxes, taxes for hotels and restaurants, advertising taxes, taxes for pets (dogs), tax for radio/TV, tax for buildings/houses, tax for cemetery ornaments, and so on.

With the implementation of the new law No. 18/1997 about regional taxes and retribution, there are now three items of taxes at the Province level, i.e.:

- 1. Motor Vehicles/Cars tax
- 2. License plate renewal tax
- 3. Gasoline/fuel of motor vehicles tax

Taxes at the regency/city level are simplified into only six items, i.e.:

- 1. Hotel and restaurant taxes
- 2. Entertainment/leisure activity tax

3. Advertising/promotion tax
4. Street/road electricity tax
5. Mining exploitation tax (for C-class mining products)
6. Utilization of ground and upper-ground water tax

Meanwhile, the equilibrium fund consists of:

- a. The regional share of the revenues from: land and building tax, fees for acquiring the rights to utilize land and buildings, and revenue from natural resources exploitation
- b. General allocation budget
- c. Special allocation budget

Percentages of the revenue sharing/assignment are given in Law No. 25/1999, based on the revenue source. For example, for land and building tax, the central government will get 10 percent and the regional government will get 90 percent. From fees for acquiring the rights to utilize land and buildings, the central government gets 20 percent and regional government gets 80 percent. The share of general allocation fund has been determined at not less than 25 percent of the national budget, and of this 10 percent will go to province and 90 percent for regency/city government. In addition, autonomy regions (regencies and cities) which own natural resources will get a certain percentage of the after-tax revenue from its exploitation benefits. For example, the central government will get 20 percent as a forest exploitation fee, while regional government will get 80 percent (16 percent to the province government and 64 percent to regency/city which owns the forest area). Similar rules are applied to other natural resources, such as general mining, fisheries, oil and natural gas, but with different percentages of revenue sharing.

The special allocation fund may be allocated to the individual regions through national budget and expenditure (APBN), based on special needs. Special needs are the needs that cannot be projected using general allocation rule, and/or the needs that have been identified as national commitment or priorities. General allocation fund includes

reforestation fees, in which 40 percent will go to the regional government which own the forest area, and 60 percent of the reforestation fees will go to the central government.

The share and the revenue from general allocation fund sectors, especially derived from natural resources, are quite limited in the North Sulawesi province; except in Minahasa regency which has gold mining exploration (with PT. Newmont Minahasa Raya / Newmont mining company). Therefore, for general allocation fund sectors, North Sulawesi province depends on the revenue coming from national budget and expenditure allocation.

After combining original revenues, equilibrium fund/budget, and other regional revenues, it is estimated that North Sulawesi province will still not have enough money to finance its regional development activities. With the amount of original revenues at approximately 35 billion Rupiah per year, it is clear that North Sulawesi province will not be able to run the regional administration. The same is true of its regencies and cities. For example, Sangihe Talaud regency can only collect original revenues of around 3.2 billion Rupiah per year, while its own level of need is about *twenty times more* than the original revenues.

In the meantime, in order to increase its original revenues, Minahasa regency has been forced to bring to court PT. Newmont Minahasa Raya (Newmont mining company). The regency is suing the mining company to perform its obligation to pay C-class mining exploration and exploitation taxes. The conflict arose from the different understanding of the definition of “C-class” mining, which is defined in regional regulations. Unfortunately, this case gave a bad impression of the investment environment in the North Sulawesi province in general, and especially of Minahasa regency, and might have a bad effect on the attractiveness this region to foreign investors in the near future.

## V. Accountability of Financing (Expenditure Assignment)

Basically, central government administration is funded by domestic revenues, which come from taxes (central government tax), regional taxes, profit/revenue from state-owned companies, revenue from natural resource exploitation, and so on.

Sometimes those revenues are just not enough to finance government administration and development activities, which therefore require some other source of funding such as foreign loan.

With the government function and authority distributions, each government level can focus on its administration function. Based on the principle that “money follows function,” each level of government ought to have sources of funds to finance its own government functions. In fact, the funds are not necessarily acquired by regional government institutions directly from their own sources. Some of the funds are part of the central government contribution/allocation to the regional government.

Each government level (including central government) is required to report the accountability of all government expenditures. In regional government, each Regency/City, and Province will have to report the accountability of their expenditures to the local people representative council / local legislative body (DPRD) at the end of fiscal year. For the central government, the accountability statement is reported to the People Consultative Assembly (MPR).

## VI. Borrowing Policy

For the first time in the history of regional government administration in Indonesia, regional government has been given the authority to obtain and manage its own outside borrowing, both from domestic or foreign sources, to finance administration and development activities by the approval of the local people representative council. This delegation of authority carries some risks, especially in dealing with loans, both domestic and foreign. During the process of negotiating any financing, the regional government has to ask permission from the central government and to follow central government regulation, and control and monitoring of the loan has to be done by the central government with tight supervision.

Monitoring and control by the central government is essential so that regional government will not be trapped into high debt, which they might not be able to pay in the future. Currently, the debt burden of the central government is already too high. If the

loans given to regional government become uncontrollable, there is a possibility that in the future regional government will repeat the experience of the private companies (“debt trap”). Therefore, it should be understood that regional government’s loans are the responsibility of regional government itself. Regional government should therefore be able to selectively pick the local projects that will be funded using domestic or foreign loan. This can be done by applying tight requirements for the loan-funded project approval. For example,

- Projects to be funded by loans should be significant to the region, and have positive effects (multiplier effects) on the local (people-based) economy;
- Projects can be regional government-owned business/companies (BUMD), expected to have high return on investment;
- The loans should not be used to build offices or buildings (non-productive investments).

Before requesting a loan, a regional government owned-company should have been audited by a reliable independent accountant. The purpose of this requirement is to make sure whether its loan proposal is necessary; whether its project proposal/plan will be necessary or beneficial for supporting its business; and also, whether the project will be able to make profits, so that it will be able to make loan payments in the future. Such tight requirements are needed to avoid the “debt-trap”problem, such as what happened to a regional government-owned drinking water company in the city of Manado, which cannot pay back its debt obligation to the central government. As a result, the drinking company owned by Manado city government will be sold to private company through a concession contract. This is an example of regional government failure in managing financing for its business.

## VII. Public Service and Civil Servants

Recruitment, personnel placement, and also personnel development and management are key concerns. Efficiency and effectiveness of employees will determine the quality of service to the public. Overhiring causes problems, since it makes unclear job descriptions, assignments, and responsibility. This problem calls for improvement in organizational management: employment requirements must be determined based on description of job responsibility and function. Rationalization of functions (to make a lean organization) is a need in government offices, so that government officials have the right capabilities/requirements for the job they are responsible for: the right person in the right position.

With the implementation of Laws No. 22 / 1999 and No. 25 / 1999, in the near future most government administration will be shifted from the central government to the regency/city governments. This means that personnel needs in the central government and province-level government will be decreased significantly. Moreover, all the vertical organizations (department/ministry office) at the province and city/regency will be disbanded. Since public service will be focused on the city/regency level, many offices at the province level will be eliminated. Many employees will be laid-off, increasing unemployment in many regions. Therefore, city/regency governments need to set up a system designed to hire new employees with the following characteristics: honesty, sound qualifications, potential, and high performance/motivation.

For certain regions, such as North Sulawesi province, the supply of educated people in every category is more than enough. Unfortunately, some may not have a professional or idealistic attitude, giving rise to low productivity, both in terms of quantity and quality of work.

In any case, public service practices need some changes, such as a commitment to give quick service and to apply the principle, “first come, first served” (to build “waiting in line” tradition). Up to now, the quality of public service in North Sulawesi province in general is still poor. There is no impression of fairness in public service, and often government employees act arrogantly or unpleasantly in serving the public.

## VIII. Accountability: monitoring and evaluation

In conducting administration functions, government needs a balanced budget (balance expenditure requirements), to perform the job well. However, revenue sources are not always sufficient to finance administrative responsibilities. That is why monitoring and evaluation are very vital for the government, since they can assure its accountability, both from the revenue side and from expenditure side. It means that the administration should be transparent to the public, and especially to the regional legislative body.

Budget reporting system should be transparent, so that the authorized parties can easily access the report for control and monitoring purpose. If necessary, the budget report should follow the “Escrow” account model. The better and clearer the report, the greater the accountability of government revenue and expenditure.

The accountability and evaluation system are essential to prevent inefficiencies, wastefulness, and corruption in using the people’s money (the government budget) which have been a serious problem so far.

## IX. Medium Term Capacity Building

The main problem in implementing Law No. 22/1999, as explained above, is the readiness of regional governments to manage the administration functions which have been delegated from the central government to regional governments. Up to now, many regional governments are still dependent on the subsidies from the central government, for both their administration and development duties. Therefore, Law No. 22/1999 has forced regional governments to adopt strategic actions, in order to benefit as expected from the delegation of authority.

For the autonomy regions (regency and city government), some of the strategic actions that should be taken are:

- Intensive studies of the quality and quantity of public service, for every administration item that has been delegated;

- Study of the possible revenue sources that might be acquired by the regional government (such as: taxes, fees, borrowing, and so on), which can cover the projected government expenditures after delegation of authority, or even finding new potential revenue sources;
- Study of possible funding sources, such as taxes, charging, fines, et cetera – to estimate regional potential for managing administrative autonomy;
- Institution-building, focusing on efficiency and effectiveness, in order to improve service to the public;
- Placement and development of professional government personnel, emphasizing dedication and idealism in serving the public;
- Planning a monitoring, control, and evaluation system that is transparent and easily applied;
- Socializing organizations and individuals to the autonomy system and its implementation, including bureaucrats, members of legislative body, non-governmental organizations, public figures, etc., in order to enhance their understanding of regional autonomy.
- increasing the participations of public/community members, by informing the public of the responsibility to help acquiring government revenues, and the right to control the accountability of government expenditure

At the Province level, the strategic actions that should be taken are:

- Institution-building, focusing on efficiency and effectiveness, in order to improve their service to the public;
- Study of the funding and the possibility of benefits that might be acquired by the province government;
- Development and allocation of province government personnel/employees to the regency/city government, based on needs;
- To take initiative on inter-cities/regencies cooperation, in order to prevent any conflicts that might arise due to the implementation of Laws No. 22/1999 and No.

25/1999. Sources of possible inter-regional conflicts are: inter-regional (inter city/regency) borders; permission for fishing in ocean areas which belong to city/regency government; development of sectors/areas which overlap (have common interests) in several regions; and so on.

- Socializing province government officers, members of legislative body, public figures, etc. on the autonomy system and its implementation, in order to enhance their understanding of regional autonomy. Increasing the participation of public/community members, by informing public of the responsibility to help acquiring government revenues, and the right of community members to control the accountability of government expenditure.

At the national level, it is expected that the central government will soon set up the necessary government regulations and other regulation guidelines, consistent with the implementation of Laws No. 22/1999 and No. 25/1999, and will withdraw any previous regulations which are not consistent and which give many disadvantages to the region/regional government.